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THE FARM CREDIT SYSTEM CRISIS

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THE FARM CREDIT SYSTEM CRISIS

THURSDAY, APRIL 16, 1987

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Marianna, FL.

The committee met, pursuant to notice, at 10 a.m., in the Circuit Courtroom, Jackson County Courthouse, Hon. Lawton Chiles (chairman of the committee) presiding.

Present: Senator Chiles.

Staff present: Dave Williams, analyst for energy, environment and natural resources.

OPENING STATEMENT OF CHAIRMAN CHILES

Chairman CHILES. Good morning. We are here today to talk about the Farm Credit System. We all know it's in trouble, but you know it much better than I do. That's one reason why I'm holding a hearing here—to hear from you and get some information from you about it.

HISTORY OF FARM CREDIT SYSTEM

The Farm Credit as a system in this country, was started because it was tough for farmers and ranchers to obtain financing. President Teddy Roosevelt, a rancher himself, sent a delegation to Europe to study how Europe provided credit to its farmers.

However, it wasn't until July 1916 during the Wilson administration that the delegation's recommendations paid off with the enactment of the Federal Farm Loan Act, the cornerstone of our present Farm Credit System. That act divided the country into 12 Farm Credit Districts and set up the Federal Land Bank.

Over the years, through the depression and war time, through times that were good on the farm and times that were awful, the Farm Credit System has been modified to meet changing conditions.

FARM CREDIT SYSTEM NEEDS MODIFYING

Now we know conditions have changed again. And what we need to figure out is the best way to keep some financing available for farming at a time when agriculture's being pinned to the board by hard times.

The Federal Land Bank provides long-term credit secured by first mortgages on the farm or rural real estate, and their operation accounts for about 40 percent of the lending.

The roller-coaster path of the dollar, high interest rates, the sharp downturn in exports, and low prices have all conspired to drive down the value of property. And that puts the credit system in a box. Some people are afraid it might be a pine box.

That certainly is devasting, not just to farm operations alone, but to the whole rural economy.

I'm told that about 30 percent of the loan volume in this area is nonperforming. That's the term bankers use when people can't pay or make their payments.

A lot of people read the papers, watch TV and hear that agriculture's in trouble, but I'm not sure they understand as well as they should what that means for the whole country.

It's easier to get complacent when the grocery store's just down the street and people don't think about the work and worry behind the goods on the counter. But there's an old saying that you never appreciate what you've got until it's gone.

And right now, agriculture and rural America are on the edge of a cliff in a high wind, and when farms are in trouble, I think we're all in trouble.

CONGRESS WAITS FOR RECOMMENDATIONS

So the Budget Committee isn't an authorizing committee. We don't write the farm credit legislation. But we do lay out the guidelines for spending the money allocated for programs throughout the government, and we do worry about deficits. But we also understand the need for investments. And the day we stop investing in agriculture and in rural America, is the day we stop a lot of things in this country.

Congress is waiting right now for formal recommendations from the Farm Credit System and the administration about what needs to be done to protect the System's ability to provide capital in agriculture. We don't have the legislation yet. Of course, the price tag will be of interest to everybody, but particularly to those of us that are on the Budget Committee.

No plan that's written in Washington and no amount of money will do us much good unless we stop and listen to the people who need the credit. It won't do us much good unless we know the practical, daily life problems of the folks that the Farm Credit System is designed to serve.

The Congress gets handed some grand design with an impressive name and there's temptation to say, "fine let's just take that and do it and it will take care of everything."

Well, I'm not sure that it will or that that will be the answer. And that's why I'd like to hear from a number of you all as to how you feel, as to what changes we should make, and as to what we should be doing. That's the reason I'm here.

We're going to hear from some of the panels to start with. And then if you have something that you think we ought to hear, we're going to take some time and listen to that as well.

Our first panel will be several witnesses, led by the Honorable Doyle Conner, our Commissioner of Agriculture. He's going to speak to us about general Farm Credit System problem implications to Florida.

Then we will hear from L.E. McMullian, Jr., a peanut farmer from Marianna and currently the Secretary of the Florida Farm Bureau Federation. Junior is also a stockholder in the North East Florida Land Bank Association.

A third member of the panel is Herman Walker, who raises dairy replacement heifers in Leon County and who is a director of the Third District Board of the North West Florida Land Bank Association. Herman has contacted many other individuals to get their input and he'll be discussing the Florida stockholder concern.

If you all would come up now, we would like to start. And we'll start with you, Mr. Commissioner.

STATEMENT OF DOYLE CONNER, FLORIDA COMMISSIONER OF AGRICULTURE

Commissioner CONNER. Thank you very much for you're being here.

Chairman CHILES. I'd like to tell you that all your formal testimony will be included in the record. If you could brief that report in some way, it will just give us more time to have a little discussion at the end.

Commissioner CONNER. Specifically about how much time? I will paraphrase my remarks and I do have prepared testimony, about how much time do you want us to take and we'll stay within your——

Chairman CHILES. Well I think 5 to 7 minutes. That will give us more time to hear from some of the folks.

Commissioner CONNER. Thank you very much, Mr. Chairman. Senator Chiles we appreciate your coming to Florida and to north Florida in particular, to discuss a subject that we've an opportunity to be heard on, because we feel our Farm Credit System is in jeopardy. You've pointed out how long it's been in existence and what it has done for the farming community in our State and in our Nation. I concur in that it is something that has served us well. It is something that is needed for the future. It is alarming to know that we have had the extent of losses that we've had in the recent past even though it has appeared to be getting better to some extent. The figures that we have is that the system lost $1.9 billion the last year and for the year previous to that, it lost $2 billion. So we see this system, generally in the Nation is weakening even though in our district and here in Florida, we have been in a better physical posture than most of the rest of the Nation.

FARM CREDIT SYSTEM IS STABILIZING FORCE

This system has served the industry well. It has stabilized our agriculture communities to a great extent. And you mentioned the non-performing loans and the concern that we have and I've mentioned the losses that we've endured. So it is a proper time for us to get a due consideration and for Congress to give due consideration to this Credit System before it continues to deteriorate even more.

You mentioned how long it has been in existence, more than 70 years. Some of the things that has brought about some very drastic changes in the Nation or in our farm communities is that we sud-

denly have changes in real estate values. And this not only impacts on the Farm Credit System and the value of our collateral, but this impacts on borrow-lenders and all of agriculture. And you, as a Member of the Congress, you know that when we have the declining prices that we've had in recent years, it's going to lead to many problems in American agriculture in addition to the credit problems. And I'd say the credit problems are the result of a lot of other problems and we appreciate the fact that you have an interest in the total agricultural problems in this country. We dropped into a deficit blue trade situation with the world, that's a bargain. We've got to aks ourselves the question, how could it happen in America? The problem is of course of far greater consequence than our Farm Credit System even though it's a part. Everything needs to be done by the Congress that can be done to help us weather the current storm. And I hope that you'll find in your testimony here today some, some ways to improve the system. The word profitability needs to be put back in American agriculture, in Florida agriculture. We cannot do this without adequate funding of course.

SYSTEM NEEDS FINANCIAL INFUSION

We know that the more healthy districts of farm credit may have been called on to assist other districts in the recent court decision. Where those transfers were involuntary at the time, the System provided for assistance on the stronger districts assisting those that were in a precarious situation. Of course this placed a strain on the entire system. And this has increased the burden here in our district. So we know that, and I can quote the Comptroller General and I think he says, "the weakness of the Farm Credit System is a threat to the Nation's capital markets." I feel personally, that an infusion of funds into the System to shore the System up is necessary. I don't know that I can give you a number or a figure, but certainly I've heard people say, that know much more than I know about this subject, that we need at least $800 million this year to shore the System up. And we probably need approximately $1 billion for a period of at least 3 years to give the strength to restore——

Chairman CHILES. A billion dollars a year?

Commissioner CONNER. Yes; I think the authorities are estimating that an amount close to the figure I've mentioned of $1 billion a year is necessary. Now this is not all that new. We know that it's been done in other areas. Now Florida has been fortunate, we're somewhat better off than other States as you very well know, because we are well diversified. But in order for us to continue this diversification and for us to seek out new markets, there must be some profit and there must be some assurance that we're going to be able to fund our program.

SOUTHEAST HELPED BY FARM CREDIT

There's been stress on the Southeast, not just from the drought last year, when all of us in the drought stricken area of Florida, but we'd had droughts in 1979, 1981 and 1983 that helped us build up to this situation. We had four freezes out of 6 years that set us

back considerably and these other factors I had, particularly on the citrus producing area and other areas of the State.

And I simply say that Farm Credit has served the farmers well for lo these many years. And I think that you were quoting the history of the system that the inception, that it's in the past following the depression and following setbacks, that we've been able to recover, I think far more quickly than we would have otherwise, because of the system being in place. So it has served us well.

LASTING NEW APPROACHES TO FARM CREDIT SOUGHT

I think we must look at the long-term situation and some new approaches. What they are, I don't know. We need to talk about the possibilities. It might include a secondary mortgage market similar to the system used to increase funds for the housing sector, which we are very well acquainted with.

Another would be the automatic restructuring of the loan. Things are not constant on the farm as we all very well know. And for some of those reasons I've just mentioned, our income fluctuates from one extreme to another because of the weather, freezes, droughts or whatever it may be. Or market conditions, you can have ideal production situations and still have market conditions that causes your return to be very, very low. And I think something can be structured into the system too, if we can keep up with the interest payments, that the principal might fluctuate with those known factors. And I'm not talking about a life or the inefficient people to survive regardless of how well they do or do not attend their business. But when there are known factors, and we know that the farm income is going to be severly reduced or has been severly reduced, some system that's predetermined to restructure that loan and I think probably would give our borrowers some of the shoving plates that they are going to need if they survive.

I wanted to look at the short-term and the long-term situation. And remember that our farmers are just as important as the Continental Illinois Bank, the Chrysler Corp. or any of the others, the Savings & Loan Organization Insurance Corporation. And the funds that were put there, I think we know the results, it brought about better conditions and in most instances a satisfactory conclusion. Something that is responsible for food and fiber production in this country is just as important.

Thank you for being here today and if we in the Florida Department of Agriculture, Consumer Service Group can provide your office with any information as far as the production of agriculture is concerned, we'll be pleased to do so.

Chairman CHILES. Thank you. Junior, I'd like to hear from you next.

STATEMENT OF L.E. McMULLIAN, JR., SECRETARY, FLORIDA FARM BUREAU FEDERATION

Mr. MCMULLIAN. Thank you, Senator. It's a pleasure for me to be here representing Farm Bureau today. The commissioner paraphrased his remarks and I think I'd be a little bit derelict in my duties if I didn't more or less take mine line by line since I am rep-

resenting each Farm Bureau member and member of the Farm Credit System.

As most of you know, my name is L.E. McMullian, Jr., better known as Junior McMullian, and I produce peanuts, cattle, soybeans and small grains here in Jackson County.

DRASTIC ACTION CAN SAVE SYSTEM

Everyone's aware of the severe financial problems that the members of the Farm Credit System are having today. And as farmers and businessmen we certainly recognize the importance of a variety of the credit sources at the lowest possible interest rates. We need to work together as farmer borrowers, as Farm Credit staff and Senator, as elected officials, to come up with the needed solutions to the problems facing our system today. We need to do this rather than looking for someone or something to blame our problems on. I'd like to urge everyone present today to get together and work to reinstate the Farm Credit System to the respected institution that it once was.

Through the years, the Farm Credit System was known as the Federal Land Bank Association and the Production Credit Association and it offered the much needed service to the many farmers of our Nation. The Federal Land Bank and the PCA has enjoyed the respect of many for the service that it provided. Now we see that severe problems exist and that drastic action must be taken to save the System. Farm Bureau members recognize the importance of the Farm Credit System and have spent much time in developing the type policy that can work to save our system. And we have a quality book here that explains quite a bit of that. And I will touch on about seven of those points later in my talk.

We feel producers need a variety of credit sources at the lowest possible interest rates.

We also believe that the preservation of the Farm Credit System is in the best interest of the U.S. agriculture. We should take the lead in developing a long term plan for its survival. And any changes in this system should adhere to these seven points that we have in our policy book that I'm going to discuss now.

Number one, the continuation of a borrower-controlled organization. Many of the farmers have come to the idea or reached the idea, that the Farm Credit System is just like any other national institution with no control by its members. We need to be sure that the System has the input of the many local leaders. We believe it's essential that we have responsible directors on a local PCA and Federal Land Bank Board and that they take much of the initiative in solving the many problems that exist. The directors must help, not only in making the decisions on how the loans should be handled, but they also must work in the community for positive public relations.

Item two is, decentralization to the maximum extent feasible. Recently, we have seen much of the local input and control relinquished due to the efforts to centralize and merge the Federal Land Bank Associations and the Production Credit Associations. As we all know, the idea behind this move was to save expenses while providing the same level of service. What was overlooked in this

process was the positive attributes that a local association had as far as public relations and loyalty by a borrower. It appears now that the merger has not been able to save on expenses as much as we had thought at one time and they've had a severe negative impact on the loan volume overall. We believe a decentralization of much of the System could be beneficial.

Item three, lending limited to farmers and their cooperatives. The Farm Credit System, as we know, was organized specifically to lend money to farmers, but it's recently branched out into other areas such as rural housing and acquatic loans. We feel that the System should reevaluate their policies to be sure that they are lending to farmers of what ever kind and their cooperatives.

Item four is a full disclosure of financial condition. As soon as we can get the System on sound footing we need to be sure that the System uses the generally accepted accounting principles and is forthright in their financial condition.

Item five is the protection of the value of the member-borrower stock. We need to be sure that everyone realizes that we will protect the value of the members stock. Congress needs to assure the investors and borrowers in the System that the stock will be guaranteed by the government if the System should not be able to do so.

Item six is pursuit of meaningful and effective restructuring of the member-borrower loans. We realize that some of the loans are beyond the point of restructuring, as the commissioner pointed out, but many could be reworked to help the borrower and the System. Many ill feelings are developing today and have developed because of the favorable treatment being given to some borrowers.

The need is so great to liquidate acquired property that some loans are being made with cheaper interest rates and even no stock requirements. If similar deals could have been made to farmers who lost their property to foreclosure, they may have been able to service their loans. Farm Credit should strive to get everyone on an equal and fair basis.

Item seven is prompt infusion of Federal Government capital as needed, and again the commissioner pointed this out. We feel strongly that an infusion of capital is needed before the System reaches the point it is beyond help. An infusion soon could bail out the System before it is too late. Any infusion should be structured in such a way that it will lower the interest rates of the member-borrowers. We must realize that the System is hurting because the farmers are hurting, in order to help the System we must help the farmers.

NATURE, LOW PRICES, INTEREST RATES, BIGGEST PROBLEMS

In our area, the biggest problems facing our farmers is due to circumstances beyond their control, and again I refer to the commissioner pointing this out. It compounded our problems when we had the drought, the freezes, plus the low commodity prices, plus we're having to pay higher interest rates than we can afford.

These high interest rates are partially caused by the losses that's incurred in other areas of the country of the Third Farm Credit District which includes Georgia, Florida and South Carolina. We

believe that the assistance from the sound banks to other district banks should be discontinued and the Federal funds should be used to shape up the System before it is beyond repair.

The inflated interest rates are like snowballs, they accelerate as the rates continue because of the loss of business that is caused by borrower flight. Borrowers who can afford to leave the System have already left and some are still leaving even though they're having a little problem, but they're still leaving because they can find interest at a cheaper rate down the road. And this is causing the cost of the interest for those left to increase above the normal rate. When things began to go bad for the farmers the Farm Credit System became much stricter on how they required farmers to obtain their credit. The decision to tighten controls had the effect of causing many of the good farmers to look elsewhere for credit which helped in causing part of the problem.

SECOND MORTGAGE MARKET CREATION URGED

We would also support the creation of a secondary mortgage market for the first mortgage real estate loans to increase the availability of the long-term credit. We support the secondary market being established within the Farm Credit System. An oversight board should consist of equal representation from the banking industry, the insurance industry, the Farm Credit System, and production agriculture.

FARMERS HAVE NEED AND DESIRE FOR SYSTEM

In summary, I think it's safe to say that the farmers have a need and a desire to see the Farm Credit System put back to the status and respect that it enjoyed for so many years. It won't be easy to accomplish this, but we believe it can be done. It will take the cooperation of many to save this System. We must remember that the original intent of the Farm Credit System was to be of service to farmers. And one last thing, let's be sure that we don't just bail out a system for the sake of the System, but rather that we help fix the System so that it can be a viable and helpful service to the many farmers who would benefit from it.

I thank you for allowing me this opportunity.

Chairman CHILES. I think that last point is tremendously important and that's part of the concern I have. Everybody knows that we've got to have an infusion of capital. We've got to put some money in there. The question is sort of how much and when? We've gone through all the sort of creative accounting things that we can do and I don't think we can go any further than that.

My concern is that before we put that money in we know whether we've got something that's going to work and that we aren't just taking the governments' siphon and sort of putting it in there because you know that's a borrowing siphon too. We're borrowing all that money, we've got this deficit which helped put the System in trouble to start with because of high interest rates. So I don't think we're ultimately doing farmers or country or anybody else any good if we just say we're going to infuse some money in, unless we've got something that you know can be viable, that can work. That's what we're trying to find out—what do we need to do and

what are the steps that we need to take. I want to make sure from the standpoint of the budget aspect that we don't just put the siphon in there without knowing whether something is going to work or not.

Herman we'll now hear from you.

STATEMENT OF HERMAN L. WALKER, DIRECTOR, THIRD DISTRICT BOARD, NORTHWEST FLORIDA LAND BANK ASSOCIATION

Mr. WALKER. Mr. Chairman and members of the committee, my name if Herman Walker and I'd like to help you make that decision. I live in Tallahassee, Florida and I'm a full-time farmer. I have been a member of Farm Credit for 20 years and a member of the Federal Land Bank Association and the PCA Association. I serve as a director of the Northwest Florida SAPCA Service Center and a newly-elected director of the Farm Credit Banks of the Third Farm Credit District of Columbia, South Carolina.

As a candidate for district director, I had the privilege of visiting with just about every director in the four States. In North Carolina, I spent 8 days, drove 2,500 miles and visited 29 of the 42 FLBA directors on their farms, had conversations with them, extended conversations.

In South Carolina, I spoke to almost every director in that State. In Georgia, I met with four of the associations as a board of the six associations in the State of Georgia. I had personal contacts with every director except three in the State of Georgia. In the State of Florida, I had personal visits with all directors throughout the State on several occasions. Also, in preparation of this testimony, I met with various local directors throughout the State of Florida as listed in the exhibit attached to my written statement.

AGRICULTURE AND FARM CREDIT SYSTEM HAVE BIG PROBLEMS

Mr. Chairman, my testimony is being given on behalf of the borrower-stockholder of the Farm Credit System.

American agriculture and the Farm Credit System are both in serious financial difficulty. A decade ago, high inflation appeared to have become a permanent part of our way of life. Land values were rising, export markets were expanding rapidly, and farm income had reached record highs. Farm credit was readily available, and this Nation's farmers were making the necessary preparations to feed the world.

Unexpected curtailment in grain exports, liberal farm import policies, and indexing by farmers and the System as a hedge against inflation, brought farm financing to the brink of disaster. The System's lending and funding operations of the 1970's and 1980's were subject to high-risk and quickly showed their weaknesses. Pricing interests rates on average cost of funds proved to be a costly lesson taught to bank management. In an effort to offset losses, the Farm Credit System continued to hold interest high. Many of its best borrowers were lost to other lenders. The financial condition of most of the borrowers remaining had deteriorated, and their collateral had declined in value, mostly due to declining land values brought on by government policy. The System, in the belief

that assistance was essential, started seeking a bailout from Congress.

System lenders addressing the problem sought information from what they considered to the best sources available. Since they determined the problem to be systemwide, they concluded that the best source was the 37 district banks; however, the answers you get depend on the person to whom the questions are asked.

BANK MANAGEMENT FORCES MERGERS

The threat from district bank management to merge or close shop caused most stockholders to vote for mergers and consolidation of their associations. The result of such mergers was the development of a systemwide series of guidelines, with supervisory control and enforcement well above the local level. Changes were made, including the retirement of employees, retraining, restructuring, recovering, and generally placing in action programs to solve all administrative whims and to appease Congress and the F.C.A. Numerous requirements, new rules and guidelines were established to correct the errors which supposedly created the problem. It would appear that the newly established lines of control were designed to remove much of the discretion of the local board and seemingly were imposed to point out that the problem rested with the local organization. Even though the major causes of the problem were beyond the control of any local board, local boards were found to be the culprit. The reason for the existence of the local board, and perhaps the system itself, has been diminished, if not destroyed. Such manipulation by bank management has resulted in an undesirable image which will require years to overcome. Respect for and confidence in farm credit is at an all time low.

RED TAPE BOGS DOWN LOCAL BOARDS

The local boards, recognizing their responsibility to the borrower for providing prompt consideration and timely response to the loan request, saw members' applications for credit become hopelessly bogged down in bureaucratic red tape. The primary responsibility of the local board, to direct management upon the three C's of character, collateral and capacity to repay, had been cluttered by complexities. With new requirements in place and local discretion preempted by boards and staff of the district banks, the boards of the local associations were able to do little more than observe the chaos. Rather than pursue loans, staffs were scrurrying around attempting to familiarize themselves with unworkable procedures that did not meet the financial needs of the farmer, in order to comply with the directors from above. The staff had to put greater emphasis on review, paper shuffling and satisfying bank management than on meeting the needs of the borrowers. These mandates have usurped the man power of the local associations.

NEW LEADERSHIP BRINGS CHANGE AND PROBLEMS

It should be apparent that a lender who does not continue to make loans and who dwells solely on mandated procedures, works no better in the Farm Credit System than in any other financial institution. New leadership or levels of authority almost always

bring change. But change does not always bring progress and success. Interest rates are not competitive, loan processing is cumbersome with untimely delays. There are two new levels of bureaucracy for approval. It is difficult to understand and comprehend all the changes that are taking place in Farm Credit. The stockholder has little knowledge of the changes and complex issues that face the districts or the national system, such as loss sharing, capital sharing, preservation agreements, the 1971 act, the 1985 and 1986 amendments to the act, GAAP, RAP, FCA, FCCA, the Capital Corporation, the Federal Funding Corporation, the Farm Credit Counsel and so forth.

Neither does the stockholder understand the 53 lawsuits across this Nation within the System. The local stockholder views all these confusing complexities as someone elses making, not his. The local stockholder relies on his representative, but that representative then elects another representative, relying on him and the story goes on. But the accountability got lost in the bureaucracy, however the stockholder is footing the total bill. The philosophy of bigness, the centralization of power and control of the members and directors has proved to be a mistake. It seems that everyone has a solution to best serve his own interest. If the Farm Credit System survives many important and difficult decisions must be made in the near future.

HOW CAN FARM CREDIT BE MADE AVAILABLE?

The question before this honorable committee is, how can farm credit be made available to promote for the economic and social benefit, of the embattled farmer and indeed this Nation itself? It is respectfully submitted as follows:

1. If an infusion of funds is necessary, it must be coupled with System restructuring and appropriate sound management guarantees. In this System the borrower must elect the board which renders policies for their association and which must always remain close to the people that it serves.
2. Provisions must be made for the up-front protection of stock by infusion of capital, but ultimately, sound management should provide for stock protection.
3. The System should be preserved with local control of matters, as intended when created in 1916, and subject to review, independent of the supervisory institution.
4. There must be an immediate removal of, and a safeguard against, the bureaucracy and its usurpation of the Farm Credit System.
5. Long term viability must be assured, with guidelines that would allow the association open access to other sources of funds.

SYSTEM PURPOSE NOT BEING ACCOMPLISHED

The Farm Credit System has one basic purpose and that is to deliver a competitive source of credit in a timely manner to the farmers and ranchers of America. This basic purpose is not being accomplished. The member-stockholder at this point has to depend and rely upon the strongest force in this country, and that is the U.S. Congress. Congress has the vast resources to answer and re-

solve the complex issues and problems that face farm credit, which has served rural America for so many years. In turn, rural America has very proudly served all of America and many other parts of the world. If the functions and responsibilities are not returned to the local board, with control and accountability, by complete restructuring of the System, I then suggest that Congress should not infuse funds, but rather legislate the unsound portions of the System to the Farmers Home Administration and bring this matter to a close. I say this because a system that is not capable of timely channeling funds to the deserving borrower has already failed and is unworthy of additional funding. The Farm Credit System must become a part of the solution to the agricultural crisis rather than a part of the problem itself.

Thank you for this opportunity to address you on behalf of the borrower-stockholder.

Chairman CHILES. Thank you very much.

[The following was supplied for the record by Mr. Walker:]

TESTIMONY INPUT PROVIDED BY FLORIDA FARM CREDIT ASSOCIATION MEMBERS

The following named individuals provided input relative to the present farm credit situation and my statement. Each person named represents member/borrowers from every Florida association, in either the Federal Land Bank Associations, P.C.A. Service Centers, or both. In my statement, opinions and input were made individually, rather than as elected representatives.

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SYSTEM'S PROBLEMS BREWING BEFORE CENTRALIZING

Chairman CHILES. I thank each of you for your testimony. You have all mentioned the part of decentralization, of a need to decentralize again as centralization is a problem. The System was in trouble, though, was it not, before we had the centralization? In other words centralization wasn't what put the System in trouble to start with, was it? It was already in trouble. Centralization followed as a means of trying to say, if we do this we can get it out of trouble, which hasn't necessarily worked. Is that right?

Mr. WALKER. The System has been more centralized than what it has advocated for several years. Mandates have been coming from above, from district level for several years. The records as introduced from loan portfolios and the decisions should make them a topic, actually to use usurpation was about as good a word as you could say for it.

Chairman CHILES. Right. Well I guess what I'm trying to understand is the history of the thing. And I want to know if I'm right or not. Was the System in trouble, and one of the ways the bureaucracy thought they were going to get it out of trouble was by centralizing it? Closing some offices to save money and doing some centralizing doesn't seem to have worked. But what I'm asking is, is just decentralizing and money going to get the System out of trouble? Were there problems that were greater than that? Are those problems still there? How do we deal with those? In other words I can understand people don't like the centralization of the System. It did move the System from local control, from where local decisions were made. But is the answer to our problem, just decentralizing money?

Junior?

Mr. MCMULLIAN. You know I really can't answer that. I think it will be on the correct road back to where we need to be, but I, to answer it 100 percent, no sir, I can't do that. But it will be a step in the right direction.

Chairman CHILES. Mr. Commissioner, do you have an opinion?

Commissioner CONNER. Senator, I don't know that we have been in a position to analyze the consequences. You point out that there was a situation and then a change and would another change back to or to something else solve the problem. I don't know that that is a major and at the same time I don't work with it daily as closely as these gentlemen do. I don't know that that would ultimately solve the problem. I think the organization has to move as smoothly as possible to facilitate our ultimate goals. And I think we've all mentioned a few things that we think are basic.

Mr. WALKER. Farm income would take care of that, Senator. Farm income has caused a lot of problems with the Farm Credit System.

CONFIDENCE NEEDED AS MUCH AS PROTECTION

Chairman CHILES. I'm sure that that's one of the major problems. One of the other things that most of you mentioned in your testimony is the need to protect the stock ownership. Now again, we're talking about two things. We're talking about Uncle Sam coming in here with a bailout, infusing money in and protecting stock own-

ership. Was not stock ownership supposed to be the reason that people were going to follow these loans to start with, to see if we made prudent decisions and prudent lending practices because they've got some kind of stake or some kind of investment which could be eaten up if those loans go bad.

And if we're totally going to protect the stock ownership, do we get that kind of oversight or that kind of protection?

Commissioner CONNER. Senator shouldn't it be put, there again as an observer and as a borrower, I think you may be talking and I did not allude to this, but we may be talking about confidence in the System as much so as we are protecting those who we have hold stock. If you scare away your good borrowers and I think the other two witnesses dwelled on that, if you scare away your good borrowers, what are you left with?

Chairman CHILES. I understand that's one of the big problems.

Commissioner CONNER. So it goes beyond, I think it goes beyond maybe the way you stated it. I understand what you're saying and that is cause for concern, but I think it really goes beyond that because there's got to be, not only we say an infusion of capital, but there's got to be an infusion of confidence and if you were threatened to be in a more substantial borrower, if you're threatening with carrying a disproportion part of the responsibility, you would probably choose to not be that much of a participant in the program, which would further jeopardize and I thnk that's probably what they're saying more so than just the protection of the dollar.

There's got to be a degree of stability that you're going to have to have for recovery.

Chairman CHILES. Does that sum——

LOCAL BOARDS SNUBBED IN LENDING POLICIES

Mr. WALKER. Senator Chiles, I would like formally to ask, maybe if you would investigate the actual losses of the System and see how those losses would be attributed between the local direction that the local boards gave the system and the losses that were attributed to management and their decision for loans. That might help in your decision.

Chairman CHILES. I see. So what you're saying is that you think those losses were occasioned by a change in economic conditions as opposed to poor underwriting?

Mr. WALKER. No sir. We're speaking here of Farm Credit and basically talking about the structure of Farm Credit. And we're speaking of stock and that guaranteeing the stock, the loan cooperatives will be sound, because you've got an investment and if the investors elect the directors on a local level to protect that investment. Again I state that the removal of the directors in making those decisions has been for several years in some areas up as high as 5 or 6 years. So before the State has these losses, let's see where the losses came from and who made the decisions. See if they were decisions made by management or if they were decisions made by local directors.

Chairman CHILES. I see. So you're saying, protect the stock until you get the authority back into the hands of the local directors and then allow them to see if that is it?

Mr. McMULLIAN. I'm going to have to agree with Mr. Walker there that the local boards, I don't think have had enough say so in their lending policies. I think that the decisions on the loans were made at a higher basis.

Chairman CHILES. And that really started in what year then?

Mr. McMULLIAN. As he said, probably 5 or 6 years ago or maybe a little bit longer. It probably attributed as much as anything to the losses in the system.

Chairman CHILES. Well I want to thank you all for your appearance and your testimony here. And if you have additional ideas, I hope you will feel to let me hear from you. I'm seeking a lot of information.

Our second panel consists of Jere T. Thorne and Marvin R. Duncan. Mr. Thorne is the chairman of the Third District Board of Directors and a full-time farmer from Camilla, Georgia. He'll be discussing the concerns of the Third District Bank. Marvin Duncan is one of the three directors of the Farm Credit Administration, and formerly a vice president of economics with the Federal Reserve Bank of Kansas City, where he directed the research in agriculture and economics. He'll discuss some of the system life problems and the Farm Credit Association's position on these issues.

Again, thank you both for coming down here today and for your appearance. I'd like to tell you that your statements in full will be included in the record and if you could find a way to brief those for us, it would just give us a little more time for our discussion.

We'll start with you Jere.

STATEMENT OF JERE T. THORNE, CHAIRMAN, BOARD OF DIRECTORS, THIRD FARM DISTRICT

Mr. THORNE. OK. Thank you very much Senator and other members of the agricultural community here today. I appreciate the opportunity to be here. To introduce myself, I'm Jere Thorne, and I'm chairman of the board of directors for the Third Farm Credit District. I was elected by the Federal Land Bank Association in the Third District. In presenting this testimony today, I'm here in place of Mr. Love our CEO, who would have liked to have been here. He has a daughter who is graduating from college and we pretty well insisted that he not miss that. He regretted missing this hearing.

The third Farm Credit District serves farmers and cooperatives in four States, Florida, Georgia, South Carolina and North Carolina.

I speak to you today on behalf of the board of directors and the members of the three banks of our district. Our Land Bank Associations currently finance approximately 50 percent of the farm real estate debt outstanding in Florida, and our South Atlantic Production Credit Association provides about 33 percent of the nonreal estate debt outstanding.

FLORIDA IMPORTANT TO BANKING COOPERATIVES

As of February 28, 1987, there was a total of more than $1.3 billion loans outstanding in Florida. Thirty percent of the $4.4 billion in loans outstanding in the district are in the State of Florida.

Financing for Florida cooperatives comprises 72 percent of the loan portfolio for the Columbia Bank for Cooperatives of $173 million. So you see the importance of Florida to our Bank of Cooperatives.

Here in Northwest Florida, Farm Credit serves over 2,200 members with over $109 million in loans outstanding.

COLUMBIA FARM CREDIT BANKS PROBLEMS

At this time, I would like to turn to an overview of the issues and problems that are facing the Banks of Columbia this year. Since the Farm Credit System is a single-purpose lender, making loans only to agricultural interests, our problems directly mirror those of the farmers we serve.

The Farm Credit Banks of Columbia are facing four basic problems. First the Federal Land Bank, has debt costs associated with high interest bonds with long maturities issued during the late 1970's and early 1980's. Second loan losses on farm mortgages and operating loans have reached unacceptable levels. Nonaccrual loans and acquired properties. The interest expense of carrying nonaccrual loans during 1986 was approximately $58 million. Number four, financial assistance to other districts has increased our need to borrow money and added interest expenses to the Third Farm Credit District farmers who can ill afford to pay the high interest cost caused by this assistance. To date we have booked over $200 million to aid seven other banks in the System.

CHANGES NECESSARY TO RESOLVE PROBLEMS

Now I'd like to go to our response, address our response to some of the current problems.

We have taken a hard look at our business to identify where changes are needed. Some of these changes were not easy to make. But they include, number one, recognizing and establishing adequate reserves for bad debts. Number two, establishing new interest rate programs based on borrowers' credit quality. Number three, merging associations. Number four, addressing weaknesses in credit administration.

MANAGING TROUBLED ACCOUNTS

Our most important priority in 1987 is managing troubled accounts. Nonaccrual loans do not yield or produce income. There are no simple answers or solutions to handling troubled debt. However, we have adopted a policy for restructing loans. We believe this policy is fair and equitable to our troubled borrowers while at the same time is fair to our other stockholders and investors.

The policy includes provisions not only for restructuring loans, but for granting forbearance. Temporary forbearance measures include reamortizations, extensions, renewals, refinancings, deferments, and maturity changes. Often, temporary forbearance will give a borrower time to realign his operation and make changes to restore profitability.

To determine if a member qualifies for forbearance, the following questions must be answered in each individual case. Does the member have acceptable financial strength, repayment ability and

the capability to work out of the existing debt burden while providing adequate risk protection to the bank and the other stockholders?

Another major step we have taken to address the nonaccrual problem is setting up the special asset management offices throughout our district. In this, we have loan officers in these offices that are working fulltime with financially stressed members, attempting to work out business solutions that are acceptable to both the members and the associations.

INTEREST RATES COMPLEX PROBLEM

Interest rates have been one of our biggest and most complex problems. Although the high cost of funds has prevented us from being able to offer interest rates that are as low as we would like, we believe that our interest rates are competitive relative to risk and servicing costs.

Our Land Bank Associations now have fixed rates ranging from 8½ percent to 3¼ percent. And the Production Credit Association has fixed variable rates ranging from as low as 7.8 percent to a high of 13 percent.

Our only mission is to furnish sound, adequate and constructive credit on a profitable basis.

DISTRICT AND SYSTEM MUTUALLY LINKED

Now that we have reviewed the situation in our district I would like to take just a little more time to address the problems of the Farm Credit System and how they relate to our district. The district is a part of the System and we are jointly and severally liable on the debt obligations. The district and the system are mutually linked. We are not an island to ourselves. We believe that financial conditions within the Farm Credit System require that the Treasury shortly deliver on the line of credit which Congress envisioned in the 1985 amendments.

In 1985, Congress adopted legislation that significantly modified the System's charter, the Farm Credit Act of 1971. Investor confidence was restored when legislation establishing access to Federal funds was passed.

The Farm Credit Amendments Act of 1985 reorganized the Farm Credit Administration so that it now functions as an arm's-length regulator of the System.

The 1985 amendments established a new institution. The Farm Credit System Capital Corporation, with power to marshal the resources of the System for the purpose of "self-help". The expectation was that Congress would appropriate Federal funds to assist the System when and should its own resources become insufficient. It should be kept in mind that no specific amount of funds were provided to the System; additional legislation, certification by FCA, and a request by the Treasury are required for this purpose. These amendments also provided protection for stockholders who invest in the System by prohibiting any transfer of "B" stock and allocated surplus as a part of financial assistance to other districts.

COMPETITIVENESS AND STABILITY DIFFICULT

While the provisions of the 1985 amendments were being implemented, circumstances were occurring that had great impact on the System's ability to stabilize and remain competitive.

System surplus declined from $3.4 billion at the 1985 year-end to $1.4 billion at 1986 year-end of which more than half is in the associations.

As a result of noncompetitive interest rates and a general lack of borrower confidence, the System experienced the loss of substantial numbers of financially sound borrowers to other lenders.

For these and other reasons, from a peak of over $85 billion in total outstanding loans at the end of 1983, the System's loan volume fell to $54.6 billion as of December 31, 1986 and it continues to decline.

CONGRESS RECOGNIZES SYSTEM'S CRISIS

Due to the foregoing reasons, Congress recognized that the System could be on the verge of another financial crisis by the end of 1986. It appeared that the need for financial assistance was approaching faster than Congress had perceived.

As a stop-gap measure, the 1986 amendments to the Farm Credit Act were passed in October. These amendments provided accounting treatments so that the extraordinary expense associated with provisions for losses and the high cost bonds could be deferred for up to 20 years. Congress also removed the FCA's interest rate approval authority.

The 1986 amendments were never intended to provide a permanent solution to the system's problems. They were meant to be a temporary, noncash solution to buy time until Congress could review the System's problems in a more deliberative manner. Our judgment is that it is time for Congress to realize that financial assistance in necessary.

LEGISLATIVE PROPOSALS FOR 1987

Let me take a minute just to mention our legislative proposal for 1987. We appreciate the demonstration of support from Congress in 1985 and 1986. We have made a good faith effort to use those tools in coordination with our regulator.

The problems of the farming sector and the impact on Farm Credit Banks and Associations are beyond the System's resources. The System is in the process of compiling data to provide to Congress with the necessary information to make an informed judgment about the System's need for financial assistance.

In putting together a legislative proposal, the System was guided by basic principles developed through local farmer-director meetings throughout the twelve farm credit districts. These principles reflect systemwide consensus positions.

Based on these principles, we developed and adopted the following specific goals for legislation: One is to build on the framework of the 1985 and 1986 amendments. Next is to stabilize and improve the System's ability to serve agriculture over time. Strengthen borrower confidence and half borrower flight from the System by having some interim financial assistance and we need that in suffi-

cient amounts to adequately protect borrower stock and also to ensure reasonable and competitive interest rates. Number four, provide for capital sharing on an equitable basis that is between districts. Number five, provide for repayment of any Federal financial assistance. Number six, maintain agency status, and that is most important.

We submitted a System legislative proposal to the Subcommittee on Agricultural Credit of the United States Senate on March 26, 1987. It incorporates the goals I just reviewed and would establish the Farm Credit Amendments Act of 1985 as the appropriate mechanism for providing the System with Federal assistance.

In order to avoid the need for continued appropriations the Farm Credit System Capital Corporation should have a line of credit from the Treasury. The specific dollar amount of that line of credit will be recommended by the System when our financial forecasts are completed this month.

Sir, at this time I would like to tell you how much I appreciate your inviting me and allowing me the opportunity to express our views. In the Columbia District and in Florida, we have great, tremendous potential. We have many good farmers, an abundance of natural resources and a capacity and really a will to succeed. We are capable of overcoming many obstacles. We believe there is a need to maintain this System as a borrower-owned and controlled lending source for the benefit of the U.S. agriculture today and on into the future.

Thank you very much.

Chairman CHILES. Thank you sir. Mr. Duncan?

STATEMENT OF MARVIN R. DUNCAN, A DIRECTOR, FARM CREDIT ADMINISTRATION

Mr. DUNCAN. Mr. Chairman, I appreciate the opportunity to appear before this committee on behalf of the Farm Credit Administration Board. As you know, we are the financial regulator for the cooperatively organized farmer owned Farm Credit System banks and lending associations. In that role, we have the same kind of responsibilities to that Farm Credit System that the Office of the Comptroller of the Currency, for example, does to nationally chartered and commercial banks in this country.

Chairman CHILES. You're the bank examiner.

Mr. DUNCAN. That is correct, we are a bank regulator. I want to visit with you about the problems in the Farm Credit System, but before I do I want to indicate to you that the Farm Credit Administration is preparing a forecast of the financial condition of the Farm Credit System institutions for the period of the first of the year 1987, through the end of the year 1994. And that forecast is intended to provide the agency's assessment of the expected financial performance of the system.

Chairman CHILES. 1987 through 1994?

Mr. DUNCAN. That's right. Under various scenarios. And we expect that that will be completed within the week or by next week rather, and we will provide copies of that report to the Members of the Congress.

FARM CREDIT SYSTEM FACED WITH PROBLEMS

Mr. Chairman, the Farm Credit System is faced with three basic problems in my judgment. The high cost of outstanding debt, which has been mentioned. Quality of its assets, which has also been mentioned. And the management of its credit delivery system.

As you know, the Farm Credit System obtains the majority of its loan funds through the sale of securities in the Nation's capital markets. During the boom years of the 1970's and early 1980's, the Farm Credit System saw loan volume escalate rapidly, from $23 billion outstanding in 1973 to nearly $83 billion at the end of 1983. And that volume is down now at the end of 1986 to about $58 billion, $54.6 billion after the allowance for loan losses, bringing this Farm Credit System of course closer to its historic share of agricultural credit among those institutions that provide agricultural credit. It's useful to note that farmers are paying down their indebtedness rather rapidly in the current environment. Coupon rates on some of those bonds that has been mentioned are as high as 15.65 percent, and some of those issues are not going to mature until after the turn of the century. And Farm Credit System bonds and discount notes are collateralized obligations of the Farm Credit System and they do not have recall provisions.

The average cost of Federal Land Bank obligations across the System is 10.66 percent and the average maturity is about 2⅔ years.

The dilemma of course for the System is to competitively price its loans to retain customers, while trying at the same time to recover operating expenses and to cover operating expenses and loan loss provisions. And as you have heard, the System has lost substantial amounts of money in the last 2 years.

Now the other problem, that of the System's asset quality. Of its $54.6 billion of net loans outstanding, just over $7 billion are nonaccrual and another $5.7 billion are high risk and the System is carrying $1.1 billion of acquired properties. That means that 24 percent of the System's loan and loan related assets are non-performing in the banking regulators sense. Mr. Chairman, Continental of Illinois almost went down when only 13 percent of its loans were similarly troubled. Continental of Illinois has been mentioned earlier in the hearing this morning. It is useful to remember that there was a price for assistance to Continental of Illinois that included the removal of its board of directors, the firing of its senior management team and the loss of equity by its stockholders.

The third problem troubling the System is the management of the credit delivery system. Though past errors in lending without sufficient regard to borrower cash flow and repayment capacity are in the process of being corrected, the system is still plagued with duplication in layers of management and decisionmaking, inadequate tailoring of credit services to fit the emerging credit market, and a large investment in bricks and mortar, and finally a management and directorate more insular than that of its competitors.

AMENDMENTS BUY TIME, NOT SOLUTION

You have heard of the 1985 Farm Credit amendments and the 1986 amendments and I will not dwell at any length on those,

other than to note briefly that the 1985 amendments spelled out rights of borrowers and mandated full financial disclosure by the institutions to their stockholders and investors. And of course the 1986 amendment permitted regulated accounting, a departure from GAAP based accounting. Regulated accounting brings no new resources to the System. It is not a solution to the System's problems. At best it buys time to seek solutions and in the process, it leaves a burden for future borrowers who will have to meet the annual charges to amortize these costs in the System.

SOLUTION TO SYSTEM'S PROBLEMS NECESSARY

The System's problems have been developing for a long time. Some are closely tied to the general health of the agricultural sector. But, some are linked to policy and management mistakes of the System's institutions. Let me indicate that the problems will not disappear overnight. Each of the members of the Farm Credit Administration Board in testimony to the Congress have indicated that in their judgment, a legislative solution to the System's problems will be necessary this year and that it would be desirable to have that solution either in place or the dimensions of it well understood by the end of, or before, by or before the end of the third quarter of 1988. That is the end of September.

Our preliminary data from our financial forecasts indicate that by the end of the third quarter, several Farm Credit Banks will have deficit collateral positions. And by the end of the year that deficit is essentially assured for those banks. Under the Farm Credit Act of 1971 as amended, those banks can no longer issue debt in the financial markets.

Also by the end of the year, several banks will likely have impaired their borrower-owned stock on a regulated accounting basis, and will have deeply impaired that borrower stock on a GAAP Accounting basis.

CONGRESS SHOULD OVERHAUL SYSTEM

Legislative remedies being considered by the Congress could and probably should, address structural and operational changes to improve the System's performance and ensure the effective use of whatever Government assistance is provided, be it in the form of guarantees, backstop lines of credit, hard cash, or a combination of all three.

It will be important for legislation to help achieve the following objectives. First, provide reasonable assurances to farmers on the safety of their stock and on the continued viability of the Farm Credit System. Remember, however, that farmers control the Farm Credit System because they own the Farm Credit System. They hold the equity capital, risk capital in those banks and associations and they are the only equity holders, they and their other farmer owned cooperatives. Second, maintain the confidence of the investors who buy securities that the system sells to raise its loan funds. Third, resolve the system's high cost debt problems. And fourth, enable the Farm Credit System Capital Corporation to carry out its legislative role as a workout bank for troubled assets in the Farm Credit System.

With that, Mr. Chairman, I'd be pleased to respond to any questions.

RANGE OF FINANCIAL ASSISTANCE

Chairman CHILES. Mr. Duncan, can you give me any idea as to what kind of capital you think it will be necessary for Congress to provide? You're saying the solution needs to come by September. I noticed you said it could be done in a combination of ways, but give me some perimeter of what we're looking at here and tell me, if you can, anything about the report that's going to come out next week.

Mr. DUNCAN. I could indicate to you, as I have done, that the broad dimensions of that report will point to a deterioration in the Farm Credit System's financial position and the likelihood that by the end of this year, the Farm Credit System institutions or at least some of those institutions will be unable to carry out their business as usual, unless there is some outside financial assistance. It's very difficult to, and perhaps impossible, to give you a hard figure as to the cost of a solution, because it would be very, very dependent on how that solution is crafted. Backstop lines of credit and guarantees can provide a very important part and perhaps a very large part of any assistance package and will push into the future the actual cash outlays from the U.S. Treasury. But it probably is reasonable to think in terms of a range of from a few to several billions of dollars as being the dimension for perimeters of the problem. Some solutions that could be crafted will minimize the cost of that solution. But it is not a small problem, sir. It is a big and difficult problem to resolve. And it will be important to insure that assistance, when provided, is effectively and efficiently used.

Chairman CHILES. You're saying from a few to several billions of dollars. I've heard as the high range that $7 or $8 billion would be necessary this year. Is that too high?

Mr. DUNCAN. Mr. Chairman, I hear a broad range of numbers, and numbers that are given often with great specificity. I have been very careful not to use very specific numbers, because it, the specificity is going to depend on the kind of solution that the Congress sees fit to craft for that System. And I think it would be imprudent of me to go beyond, at this point the range that I have pointed out to you. The problem can be resolved over a period of years, and I certainly would agree with your suggestion that it is not a problem that does not have to have a full financial solution in this year, but the financial assistance may well have to be provided over a number of years.

Chairman CHILES. Do you have any field of range for that Mr. Thorne?

Mr. THORNE. Senator I would really hate to quote anything until the report comes out. I don't want to preempt the people who are doing the research and the work on this. The System has a little over $4 billion in capital stock, which is not available. It's hard for me to believe that we would need more than that, to use that as some kind of rule of thumb. But I'm doing a good bit of summarizing, but I've done a good bit of studying of the System too. I don't

disagree with the commissioner or whoever said that maybe hard cash would probably come into this thing sort of a piecemeal at the time.

We, I tell you, it's hard to get, this is a tremendously complex system as you know. And I have to preempt what I'm fixing to say with that to get into this. We have different districts that are, that have tremendous loss reserves. We're going to have to see whether these things develop or not. There's where the bottom line has hit and that's what creates the need for funds and creates the cost of the relative return that openly dictates what you have to charge for money. Now I'm saying that Mr. Duncan and his people are not doing a job, but I know it's almost impossible for him to tell me that in St. Paul, they are reserving exactly the same way we are reserving in Columbia. And I think these things are going to have to be worked out of a time. I have some ideas on how it should be done, but——

Mr. DUNCAN. Mr. Chairman, I have to point out that my, the range I have given you is my own professional judgment.

Chairman CHILES. I understand.

Mr. DUNCAN. I should also add to what Mr. Thorne has indicated and tell you that the system has currently $9.2 billion of risk funds. It has $3.6 billion in loan reserves that can and will be taxed as those losses in the portfolio are recognized. It has about $1.4 billion at surplus and it has $4.2 billion in primary capital that is stock of the borrowers. That is a substantial amount of money.

These funds are available in bearing the losses as they occur. If more risks show up in that portfolio, the institution will have to add further amounts to its loan reserves and indeed that has been the case for the last couple of years or more in the System.

Chairman CHILES. So it's not there in ready surplus funds, but at the time if it's $9 billion that's reserved, it's there to take care of $9 billion worth of problems.

Mr. DUNCAN. The $9.2 billion is total risk funds in the System.

Chairman CHILES. So the question then depends on how many other problems are out there. Is this the extent or are there others out there?

Mr. DUNCAN. The $3.6 billion of loan loss reserves are there as an indication of what the System institutions and their board of directors think is the risk in their portfolio. If and as the institution actually realizes the losses on its' portfolio, withdraws funds from its loan loss reserves. If conditions turned around and land values began to increase for example, then you could have institutions withdrawing funds from loan loss reserves because the risk in the portfolio was lower. And indeed I might note that net income in American agriculture will be record high this year, following a record high in the past 2 years.

FINANCING ACQUIRED PROPERTIES

Chairman CHILES. Yes sir. Mr. Thorne, what I continue to hear about, and maybe Mr. Duncan you can answer this too, in talking about acquired properties is that Columbia usually incurs the loss from property sold on the open market after foreclosure, but that you also have the practice of providing favorable financing for the

non-farm interest that acquired the property. Would you or should you not consider some kind of change in policy that would allow the farmers the same kind of terms that are offered the non-farm interest when the properties are sold? What I continue to hear is somebody you know is forced out and the property is sold at a bargain price. Then a bargain financing rate is given on that and many times the farmer feels like he could have made it himself if he had a shot at having a break like that.

Mr. THORNE. Senator I won't answer that question, I appreciate you asking that question, but I'd like to remind everyone here that I am a borrower member and I have seen the human tragedy. I come from southeast Georgia and we have been hit just as hard or harder than this area.

Chairman CHILES. I know that.

Mr. THORNE. The best friend that I have was foreclosed on by the Federal Land Bank. Now, I would love to say yes to that, but our Cooperative System is just more complex. Not only do you have the factor of good financial practice involved here, but what worries me in this system is that it's a thin line if you think about it. We have active loans over here or producing loans, but a lot of those people have just made it. If they move over into the nonaccrual and we turn around then and compromise debt or we turn around and give them a lower interest rate because they fell just under their payback ability, there's a lot of discontentment and I've heard it, from the people sitting on the other side, who are making their full payments on time with regularity. And there's also a binge in the System for them to decide and say well all I've got to do is miss a payment and they'll flip me over and I won't have to pay as much. And the System does not have the money to do that. And that's something that Congress is going to have to address, is to whether or not they want to provide those type funds and we need to identify the cost in the process. And I'm not saying that I would be against doing that, but it's, you're really boiling down to requesting something that just can't be done under present circumstances. And I would love to do. I would have loved to have done it for my neighbor.

Chairman CHILES. I understand it's more complicated than it might appear. The other thing that I hear continually is, property is foreclosed, that property is then taken out and in order to sort of get it out of the nonproducing or nonaccrual thing, it's sold at some kind of a bargain price which depresses all farm prices that are out there. The fellow who is out there working and trying to borrow money, then finds that the market is being pressed down by those kind of sales. How do we try to proffer deal with that?

Mr. THORNE. OK. On their heads up you have to balance it against. On the acquired property, if we hold that property and we're not earning income, we're going to have to charge more interest to break even, to the people who are paying. If we convert it into some type of earning asset, then that will allow us at least the ability to reduce the interest some to the people who are paying. And that is a primary factor in you know selling property on that basis.

Mr. DUNCAN. Mr. Chairman?

Chairman CHILES. Yes sir.

Mr. DUNCAN. Perhaps I could add a bit of illumination on this subject. I can't tell you exactly what the policies in the Columbia District are with the sale of acquired property, but I can tell you, for example, about the preferential interest rates provided in the St. Paul Farm Credit District which also have received some attention in the press and by the Members of Congress. In order to get that preferential interest rate from the St. Paul District as they sell their property, the buyer has to put 40 percent down in cash, and that preferential interest rate only extends for 2 years then jumps to a market rate and typically that is a contract for deed purchase, rather than a sale for mortgage.

And the St. Paul Bank has made, what I believe is a smart decision. They realize when you need to sell acquired property that you have a choice of going for top dollar on the value of that property when you sell it or for the toughest financing terms that you can get. And you can't have both, so they have decided to compromise where necessary on the financing terms in order to hold up the value of the property that they sell and on balance they have been able to sell their acquired property for slightly more than appraised value. That is to say that in their property sale program they have stabilized the value of farm real estate on the balance sheet of not only their borrowers, but every farmer in that district who holds real estate. And I would submit that that is not a bad outcome, I think that's a good outcome for farmers.

Chairman CHILES. Mr. Thorne?

Mr. THORNE. Please let me address that. St. Paul got all the publicity on that, but Columbia has been doing the same thing for several years now on our PMN's. We've been giving an interest rate of down to 8 percent, back when our interest rates were even higher. This is one of the things that we're getting complaints about, is the lower interest rate and not necessarily the lower price at which we are selling the land for.

Another thing I'd like to add about the land value, and this a very complex issue and I'm sure a lot of people disagree with it, but if the Farm Credit System is holding a large inventory of land and everybody knows you're really not going to help land values by them holding it. And they flat cannot afford to hold it number one, but the main thing is you're really not going to help land values when you have this big inventory. It's just like a big surplus of corn sitting there. As long as that surplus is there, corn prices are going to be somewhat depressed. The only way to ever get land values back, number one is for profitability to come back into agriculture for this land to move through the market for people to see that land is selling. We've had a lot of people that will not buy land because they've had the belief that Farm Credit doesn't want to sell the land. They've confused us with FHA or what not. So they're simply not seriously looking for the land. And that's a factor in your original question.

But I do want to point out that St. Paul got the publicity, but we've been doing the same thing.

PAPER SHUFFLING INSTEAD OF FUNDS

Chairman CHILES. Let me pose one other question. I'm continuing to hear a lot of farmers say, that because the System is in trouble now, it's almost impossible to get a loan. They get a lot of paper shuffling. They get sent from here to there. But it's pretty obvious to them that money is going for rural housing, money is going for other rural endeavors like that interest structure, but that when it comes to a farmer trying to get a loan, they literally get paper shuffling rather than any kind of ability to get a loan.

Mr. THORNE. Senator there's some visible support for that. But let me tell you why, the System is in trouble and we're needing all kind of information. I just mentioned in my testimony that we are coming up with a projection of the amount of money we need. To do that, we've got to go all the way down to the local associations and get those over-worked people to fill out another form and send it back in to provide the information. That's a part of the red tape of the System and it comes with the System being in trouble. So there's some visible evidence to that.

The main thing though and the sad thing and the truth, when you sit down and look and you cannot repay a loan, and the value is not there, you absolutely do not lend the money and stay in business and you're not doing the individual who wants the money a favor to lend to him. And so it's the fact that he's in trouble along with the System. And without some type of supplement or some kind of manner coming down from heaven, I don't know how we can do it.

Chairman CHILES. I thank you both for your appearance. I'd like to ask your indulgence for just a few minutes, if you would kind of sit there. I know that a lot of people out here have something to ask or something to say. I want to say at the outset, both of these gentlemen have come down at my request and I thank them for coming down. They may have some answers to your questions. Let's take a few minutes now and see if some of you all have some advice you want to give me or a question that you might want to ask. We'll try to take about 25 minutes and see what we can do on that.

Yes, sir?

INTEREST RATE VARIATION UNFAIR

UNIDENTIFIED SPEAKER. I belong to the System and I've borrowed money all my life and I've always been able to pay. But I have problems right now with the System itself due to the fact of two of the things that you asked them. That's the variation of interest with everybody owning stock, a person who has paid his payment, paid his interest, he's being charged 12 and 13 percent. Another guy can borrow money at 7½ percent or 7¾ percent. I'm having problems with the System for that reason.

The other reason is that the land that has been taken has been offered for sale and those people don't have stock. They're buying the land, I think the land ought to be at public auction if you're going to do that and give everybody the opportunity if they want to borrow the money, they should be, buy stock and pay just like I do with the System. We got into the System, Senator you know from

the $12 and $15 hundred an acre land and it has dropped down 60 percent. The only way that you can help the people in here is lower interest rates and variable interest rates is not a fair system. I'll take myself, you charge me 10 percent, you charge my neighbor there 13 percent. He has stock, he's made his payments and I have stock, I've made my payments. If he's in jeopardy, if he's in jeopardy, he shouldn't be penalized, because if you penalize him, you put him in more jeopardy. And money that's loaned at 7½ percent or 7¾ percent, it's at a loss anyway. So you're helping those people and the people who are really in trouble, you're not helping them at all. There's only one way that I think that you can help the System as a borrower and I'm currently in a current position, I've never been turned from anything, much less the Credit System. But I have been personally looking at, and my friends, many of them are changing from the Federal Land Bank to the PCA due to the fact of the variable system. And I think it's wrong and I think that the System within itself, if there's any way that the Congress could extend a loan at lower interest rates, you can help farmers. But if you continue to pour money in any System with the System like it is and if people don't borrow the money, you're going to have more people in problems. In other words, just as fast as they can get the commercial banks to take over the payments they're moving from the System. And I'm one presently thinking very serious about, and I've been a borrower for gosh all, you've got people here, 25 years, I don't even know how many years. I've paid millions of dollars in interest. And I think that if it's a true system that we all should be charged the same interest. If you're not going to charge us the same interest, don't loan us the money. And I hope that, as Congress, that they'll look at that, Senator, and treat everybody regardless of preferential treatment. I borrow money cheaper than some people, but I don't think it's right.

Chairman CHILES. Well let me just ask you, is not one of the reasons, Mr. Thorne you get into this, is not one of the reasons you come up with a preferential treatment to try to keep somebody just like you from leaving the System and going to the banking system because you can get a better credit there?

UNIDENTIFIED SPEAKER. You've given me a preferential treatment, he's paying 6 percent for money, you loaned it to me at a point and a half and you're losing money on me, so you get the System in worse trouble. You'll disagree with that, but you can't loan money at 1½ percent.

Mr. THORNE. Our policy, we want, the Farm Credit System is operated on mighty thin margins for years. And we're not lending money, intentionally lending money at too low a margin. What has evolved in this deal is that we have come up, we have really gone back to fixed interest rates. This is not new in the Farm Credit System. The variable interest rate came in the 1970's. Now I know this is a very emotional issue. But we did it for one reason and one reason only. That man that is paying 13 percent, we did it so he wouldn't have to be paying 13½ percent. We could either keep borrowers who were going to leave us or attract new borrowers at these low interest rates based on the marginal cost of money. The new funds that we're getting cheaper. But this big pool of funds sit-

ting out here, we absolutely could do nothing about it and then we had to base this on risk just like all other financial institutions do.

Now I know there's a big debate in the Cooperative System as to whether or not we could do that and that's one of the complexities of the Cooperative System. We may as well talk turkey and get it on the table. But the board, we made the decision to do that to try to help people. We didn't make the decision to do that to hurt anybody or identify anybody as being bad. We did it to try to help the farmer, the ultimate borrower, whether he was the 13 percent or the 7 percent borrower.

Just like rural home loans. We had these rural home loans and I respect the gentleman this morning that said we shouldn't be in rural home loans. But the fact that we're in the rural home loans and we can make money off of it, allows us to lend farmer's money cheaper than if we did not have the rural home loans.

So these are the things that we have to look at and we have to sit down and take holistic look at what we're doing and that we're struggling to do. God knows we've made mistakes.

UNIDENTIFIED SPEAKER. Well all I can say, if Congress tries to bail you out, because you're going to go further in. There's no way, if you don't loan money, can you make money. There's just no way unless they're going to give it to you. If you want to help the farmers here and I don't believe that there's a person here elected on the board would agree that you ought to charge me 7 percent and charge him 12 percent. And we've all got stock and we're all equal and we should be as long as we've made our payments and you've made your interest.

Mr. THORNE. So you really believe then and I'm just very sincere in this question, that if we charge everybody 12 percent we would have more borrowers than in differentiating and charging some cheaper interest rates?

UNIDENTIFIED SPEAKER. Well, I've borrowed all my life and I don't think you should have a variation.

Mr. THORNE. OK. Well I respect that and there's a lot of feelings that all the rates should be the same. But if not, let's don't confuse it with always being philosophically characteristic with the System. The System does not always lend money in that fashion.

Chairman CHILES. Let's see if there's somebody else R. D. You all can debate this a little bit afterwards out here.

ENVIRONMENTAL PROTECTION PROJECTS NEEDED

UNIDENTIFIED SPEAKER. You started on the right trail last farm bill. You voted and put into place a 4 or 5 million acre tree bank. The problems is you didn't go far enough, you should have went to about 300 million acres in America (inaudible) the year 2020 in timber. And then the farmer's would have been able, the payment being got out of the land to pay these fellows here.

You don't have to look very far, look at these broke-down farmers back here including myself and look at those two gentlemen up there, how well dressed and kept they are. [Laughter.] See what I'm saying Senator. You're vying for a bunch of broke farmers to pay those gentlemen sitting up there and to keep this thing alive. We need some environmental projects all over America. This is one

of them Senator, put the trees out there and let your grandchildren have something to build a home on and my great grandchildren to build a home on. (inaudible) the farmer, because he cannot purchase this clean air and clean water from the city of Marianna and Tallahassee and your home town of Lakeland, Florida. That's what I've got for conversation.

Chairman CHILES. Yes sir?

GUARANTEE LOAN/LAND UPKEEP A CONCERN

Mr. DUDLEY. I do private farm management work and a couple of comments I wanted to make was, for example, the 1985 legislation you provided for the Farmer's Home guarantee. And one of the problems we find in the system, they have not used those, but if you ever tried to do anything for Farmer's Home you'd know why. This is a real problem for them to use some of those things. So you've got to watch out when you make bailouts and the stuff that you put in there, they can't really use it, because of the problems with trying to get those kind of things. I don't know of anybody that's been able to get one of those guaranteed loans. I know plenty of people that have tried and so it's a real problem to try to deal with.

And the other thing that probably adds against them is they don't manage the properties that they take into inventory. If you take a farm in inventory and it's not managed, it will deteriorate which will cause further loss of value. And I think that's something that needs to be addressed, to how that property is managed after it comes in the inventory.

FARMERS EXPRESS CONCERNS

Mr. THORNE. Senator I'd like to address the FHA deal. The System is not totally innocent on that and I'm not here claiming false credit. It's been complicated. There's a lot of bureaucracy in it and the System's had a lot of learning to do about that. And I was just talking with one of our people this morning and he informed me of that. But we have made great strides and Tom if you'll ah, in North Carolina I believe we had a number of those loans. We've met with the State director several times in trying to work out these bureaucratic kinks, which I can't get into the details of that. But it's been extremely difficult, and you're right, but we're making a special effort to try to include these in our forebearance policy now.

Chairman CHILES. All right sir. Yes sir?

UNIDENTIFIED SPEAKER. I use to farm in Liberty County and we borrowed a lot of money from your system and a lot of other system's also. If you're going to bail them out and put all this money into them, wouldn't it be better to help some of the farmer's out and give them the money and say pay off some of their debts?

Chairman CHILES. Yes sir?

Mr. ABBOTT. My name is Lacy Abbott and I'm also in private farm management. On page 6 of Mr. Thorne's report, I'd like to point out where it says we're talking about people who are in trouble, farmer's who might qualify for forbearance. We see point one, acceptable financial strength on an individual basis. All these

basis' here are for people that don't need your help. In other words, you will help someone who don't need it. You give the interest breaks to persons who have 40 percent cash up front. Now that's not any of these farmer's out here. That means that somebody with money outside comes in and competes with these farmers. Gains tax breaks to over produce the commodity that they're going to have to compete against. So what I see from the Farm Credit System, is let's get our money and we want a bailout from the Congress. We want to take the money and put it in the non-farm investments, because the farmer is not going to be able to pay it back. So it's a thing to protect the System and let the farmer's go down.

Chairman CHILES. Mr. Thorne I'll give you a chance to respond to that.

Mr. THORNE. When I read those, I said the same thing you did. I said if everybody had those characteristics anybody would lend them money.

That, the wording on that has been changed somewhat to the, and I have it here in front of me. The borrower has acted in good faith, the question is, has the borrower acted in good faith? Can the borrower present a plan with a reasonable assumption for the high profitability of return to financial liability? And will the chosen alternative minimize loss to the members? Now that's taking a little different approach, but even in those, with that criteria you have there, what really makes the thing work is looking down the road. Are you going to lend somebody money and make them sound or are you just going to lend them money and that's going to be it? So what you have to bring into it is our, not only the restructuring, but the forbearance and the things that I mentioned in my talk, that measures this thing and makes it come together, is that when we do extensions, renewals and what not to analyze these people to see if they can be put back sound. I think your concern was very legitimate about what's written up in the piece.

Chairman CHILES. Herman? I mean Junior?

Mr. MCMULLIAN. If you will allow me to be facetious for just a moment. R.D. is not here, I probably shouldn't say anything, but the statement he made, is the first time ever I guess that we've been 100 percent in agreement. [Laughter.] I would like to take it just a little bit further. For instance a farmer might have the collateral if he wanted to buy some of this property that was available, he might have the collateral that he could put up——

Chairman CHILES. R.D. your name has just been taken in vain. [Laughter.]

Mr. MCMULLIAN. He would have to put up stock in order to buy that, but this individual that's an investor or whatever could come in with the cash money or whatever the down payment was with no stock whatsover in that thing. Where if that individual, I'll give you myself for an example, and I've been able to have bought that piece of property, I might be a more viable farmer today than I am. And that's the way it could work.

Senator CHILES. Yes sir?

UNIDENTIFIED SPEAKER. Senator from what I've heard, I'm a dirt farmer in the county. From what I've heard from these gentlemen that if they don't get a bailout, we're not going to have any Farm

System. Now in view of that, it might be important to consider what they revealed. However, I do think the System does need to be (inaudible) to human sympathy. I know of a case that back in 1978, the farmer made a land purchase and the Farm Credit Service gave that farmer a call and insisted that they finance that purchase. And that farmer informed them that he intended to go to long-term financing. But they (inaudible) and he borrowed the money on their terms. Now when the time come that he was having trouble serving his loan, he didn't get much sympathy or concern. Just you know if you can't serve the loan it's up to you to figure out what to do to restructure and (inaudible) the loan. Well that farmer, all the time could have serviced his interest on his debt. If he couldn't have paid on the principal he could have serviced the interest. Now to me it would have been doing the farmer a favor to give him a chance to service his interest on his debt. He would be using the money, if he paid it back, they were going to loan it to somebody else. Now that farmer could have eaten a lot better and he wouldn't have had the hardship that he has had if something like this could be. So if the money is funded, I would like for this to be considered and talked about, that the farmer, the one that's doing the producing and (inaudible).

Chairman CHILES. Well I agree with what you're saying, but how in the heck to do it, is what I'm here trying to figure out. We're putting $25 billion in the farm subsidy programs now, and 5 years ago I think it was $8 billion, and we've got more farmers going busted today than we had 5 years ago.

Yes sir?

PAPERWORK BURDENS SYSTEM

Mr. STEVENS. Senator, I'm Doyle Stevens from here in Marianna or Grand Ridge here. And I'd just like to bring back the talks about paperwork. It's not just the bad loans that are being lost because of the paperwork. Because of reports Mr. Duncan that has to be done, because we have lost, I've worked also as a director for the Federal Land Bank District here. And there's a lot of good loans being lost because we're getting request for reports that has to be back in 10 days or sometimes even less. And I would ask one thing, if you could help us out in this manner, we could keep employees better and longer than, that we're training. And also, if you give us any help with an infusion, please don't require any more reports. [Laughter.] Because we'll not be able to loan the money. If we've got Congress to report to, we're in serious trouble, on top of these. I fuss with Mr. Thorne here and the bank officials when we're meeting with them. I don't get a chance at Mr. Duncan much, but I wanted to let you know, please don't do that to us.

Chairman CHILES. Well I thank you and I want to thank——

Mr. DUNCAN. I want to comment very briefly on that because I think there is a paperwork burden in the system as I think Mr. Thorne does. Now I've been around agriculture all my life. I grew up in feed yards and grain elevators. And any time a country banker had problems, he said you know I'd love to stay with you, but it's the regulator. Or I wouldn't ask you this information, but it's the regulator wants it.

Well let me tell you who all is requiring information from that PCA. We are mandated by the Congress to annually examine every association and bank in the System. And if we don't do it right, they're going to find somebody who will and they should. The Columbia Bank has loaned money to the PCA and it has a better creditor relationship than it has to maintain. The Farm Credit Corporation of America, you've heard about that, that's another (inaudible) out of which the numbers Jere is talking about will come. And they are collecting data from every institution in the System. The Capital Corporation is going into institutions where the borrower stock has been impaired and where the bank needs or association needs assistance. And before they provide any, they are making a business decision as to whether or not the records are in appropriate condition.

Now the healthy banks and healthy districts, yours being one of them of course, is insisting on that. So when you have troubled institutions, you sometimes have a proliferation of paperwork. But paperwork is a problem and do you know that the Farm Credit System by and large requires about the same level of paperwork from a $5 or $10,000 borrower as it does from a $5 or $10 million borrower.

Now in my testimony Senator, I suggested the System has to develop new and better loan programs, better matched to the needs of the borrower. That's one of the areas where there can be some reduction in paperwork and where it needs to happen. And I certainly encourage system institutions to develop better loan products for their borrowers.

Chairman CHILES. Mr. Duncan and Mr. Thorne, we thank you for coming down here and I thank each one of you for attending. I want to say again that if you have other information, please feel free to put it down. I'm not sure that I have all the answers from today, but I'm glad to get exposed to a lot more of the problems. Thank you very much. We will recess.

[Whereupon, at 12:15 p.m., the committee was adjourned.]

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